

California Workers' Compensation Insurance Market Overview

The Department of Insurance has received numerous calls about the increase in workers' compensation insurance premiums. The Department realizes that recent increases in premiums have placed a burden upon employers. Commissioner John Garamendi's inaugural speech of January 6, 2003 addressed the workers' compensation issue as one of his top priorities. The Commissioner formed two advisory panels; one made up of insurer representatives and the other of consumers (workers, employers, and consumer advocates), to assist him in getting an overview of the problem and possible resolutions. Those advisory panels submitted numerous recommendations to the Commissioner in February 2003. (Click here to see the [Commissioner's action plan](#) based on the findings of the advisory panels, and the press release regarding the [State Compensation Insurance Fund](#).)

A brief overview of the workers' compensation insurance market in California follows:

1) Workers' compensation costs are increasing for a number of reasons, particularly due to sharp increases in claim costs which include, among others, medical payments and indemnity claim payments. Despite reports by the Department of Industrial Relations that the number of nonfatal job-related injuries/illnesses have declined, and by the Workers' Compensation Insurance Rating Bureau (WCIRB) that claim frequency has decreased, claim severity (the average cost per claim) has continued to increase. This increasing severity phenomena has caused insurers to increase their loss reserve liabilities and rates significantly.

2) In 1995, the pricing of workers' compensation insurance was changed by the Legislature from the California minimum rate law to competitive rating (open rating). Under open rating, insurers were able to set their own rates. While companies were required to file their rates with the Department of Insurance prior to their use, the law did not give the Insurance Commissioner the authority to set the rates.

Companies began to fiercely compete for market share. Insurers cut their rates and granted discounts to attract business. Consequently, employers and business benefited by paying lower workers' compensation insurance premiums. However, insurers subsequently found that the premiums charged during the first six years of open rating were, in the aggregate, significantly inadequate to cover their costs, even with investment income added to the equation. Many insurers who had focused on gaining market share became insolvent.

Additionally, capital and capacity in California was seemingly augmented in 1997 and 1998 with the ready availability of reinsurance (insurance for the direct insurers). However, problems later arose when greater than expected losses emerged and reinsurers began to dispute or rescind their contracts. Several workers' compensation insurers encountered financial difficulties when their reinsurers gave notice of their intent not to pay losses under the terms of the reinsurance contracts.

Faced with increasing medical and indemnity costs, continuing adverse experience from prior years' losses, lost reinsurance coverage and higher reinsurance costs, and less investment income, insurers have had to face hard facts. Their rates, coupled with questionable discounts and weakening underwriting practices, had not generated sufficient revenues to cover their losses and expenses.

The insolvencies of several California workers' compensation carriers in the past few years only highlights the seriousness of the current workers' compensation market. Other insurers have

Effective January 1, 2003, Commissioner Low approved a 10.5% increase in advisory pure premium rates for new policies and policies renewing on and after January 1, 2003, and a 4.9% increase for policies with unexpired terms having anniversary rating dates on or after January 1, 2002 and prior to January 1, 2003. A major part of this increase was due to the estimated cost of the increased benefits bill enacted by the legislature (AB 749), which was estimated at 9.7%. Because AB 749 requires increased benefits to be phased in over a 4-year period, pure premium rates will be adjusted through the end of 2006. The Workers' Compensation Insurance Rating Bureau (WCIRB) estimates the effects of AB 749 to result in a 7.8% increase in pure premium rates in 2004, a 3.5% increase in 2005, and a 2.9% increase in 2006.

Effective July 1, 2003, Commissioner Garamendi approved an overall 7.2% increase in advisory pure premium rates for new policies and policies renewing on and after July 1, 2003. The WCIRB had requested a 10.6% increase due to continuing deterioration of medical loss experience.

The following is a recap of historical rate changes from 1989 to 1994 under the minimum rate law and a summary of the advisory pure premium rate changes from 1995 to 2003:

***California Workers' Compensation Insurance
History of Rate Level Changes***

Year	Amount Requested By the WCIRB*	Amount Approved By the Commissioner	Effective Date
1989	+2.60%	-1.00%	01/01/1989
1990	+5.90%	+4.90%	01/01/1990
	+1.00%	+1.00%	03/01/1990
1991	+5.80%	+5.80%	01/01/1991
1992	+11.90%	+1.20%	01/01/1992
	+23.10%	+6.70%	07/01/1992
1993	+12.60%	Not Adopted RH-309, Ruling #281	01/01/1993
	-----	-7.00%	
		(from rates in effect on 07/01/93) Per AB 110, effective:	07/16/1993
1994	-9.20%	-16.00%	10/01/1994

Year	Amount Requested By the WCIRB*	Amount Approved By the Commissioner	Effective Date
1995	-7.40%	-18.00%	01/01/1995
1996	+18.70% [applies to advisory pure premium rates]	+11.30%	01/01/1996
1997	-2.60% [applies to advisory pure premium rates]	-6.20%	01/01/1997
1998	+0.50% [applies to advisory pure premium rates]	-2.50%	01/01/1998
1999	+5.80% [applies to advisory pure premium rates] (original proposal: +3.6%, revised Sept. '98)	0.00%	01/01/1999
2000	+18.4% overall [applies to advisory pure premium rates]	+18.40%	01/01/2000
2001	+10.1% overall [applies to advisory pure premium rates] (original proposal: +5.5%, revised Sept. '00)	+10.1%	01/01/2001
<p>** After completing its analysis of accident year loss experience as of 6/30/2000, the WCIRB amended its proposed increase from 5.5% to 10.1%. The revision was due to sharply increasing loss development, particularly for the 1998 and 1999 accident years.</p>			
2002	+10.2% overall [applies to advisory pure premium rates] (original proposal: +8.5%, amended Sept. '01)	+10.2%	01/01/2002
<p>** On 9/21/01, the WCIRB amended their proposed increase based on more current loss experience and recently adopted changes to the inpatient hospital fee schedule. They also proposed an additional mid-term rate increase for "in-force" policies (effective 01/01/02) due to the hospital fee changes and the possible increase in the cost of benefit levels resulting from recently passed legislation [SB 71 & AB 1176]. A proposed 1.1% increase, for just the increased inpatient hospital fees, was rejected by the Insurance Commissioner. Likewise, a proposed 7.2% increase for in-force policies (had SB 71 and AB 1176 been enacted) was denied since the bills were vetoed by the Governor.</p>			

Year	Amount Requested By the WCIRB*	Amount Approved By the Commissioner	Effective Date
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2002	+10.1% overall	+10.1%	07/01/2002
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[Filing submitted 03/28/02: applies to advisory pure premium rates for new and renewal policies with anniversary dates on or after July 1, 2002]

** This increase was due to the continuing deterioration in loss development and does not reflect the cost impact of AB 749 (the increased workers' compensation benefits bill, Chapter 6) which was signed by the Governor on 02/15/02 and filed with the Secretary of State on 02/19/02. These will be reflected in the WCIRB's 01/01/03 filing.

2003	+13.4% ^{*1} overall	+10.5% (for new & renewal)	01/01/2003
	+5.9% ^{*2}	+4.9% (for unexpired terms)	01/01/2003

[applies to advisory pure premium rates]

*[*1: Original filing submitted 07/31/02: the proposed 11.9% increase would apply to advisory pure premium rates for new and renewal policies with anniversary dates on or after January 1, 2003; later amended in September to +13.4%. **]*

*[*2: The proposed 5.9% increase in advisory pure premium rates would be applicable to the unexpired term of policies with anniversary rating dates on or after January 1, 2002 and prior to January 1, 2003, as of January 1, 2003.]*

** The original amount of increase of +11.9% was mainly due to the estimated cost of AB 749 (the increased workers' compensation benefits bill signed by the Governor on 02/15/02). The estimated impact of AB 749 on 2003 policies is 9.7%. [For further info, see Part A, Section A, Appendix C of the WCIRB's filing.] The proposed increase was later revised to +13.4% based on the loss experience through June 30, 2002. CDI Hearing Date: 9/20/02.

	+10.6% overall	+7.2% (for new & renewal)	07/01/2003
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[applies to advisory pure premium rates]

[Filing submitted 04/02/03 & hearing held on May 8th: applies to advisory pure premium rates for new and renewal policies with anniversary rating dates on or after July 1, 2003]

** The proposed change is due to insurer losses incurred during 2002 and prior accident years valued as of 12/31/02, and insurer loss adjustment expenses for 2001 and prior. The 01/01/03 change was based on 2001 and prior accident years loss experience, evaluated as of 06/30/02. Since the last evaluation date, medical loss experience continues to deteriorate.

* **WCIRB:** California's "Workers' Compensation Insurance Rating Bureau"

Note:

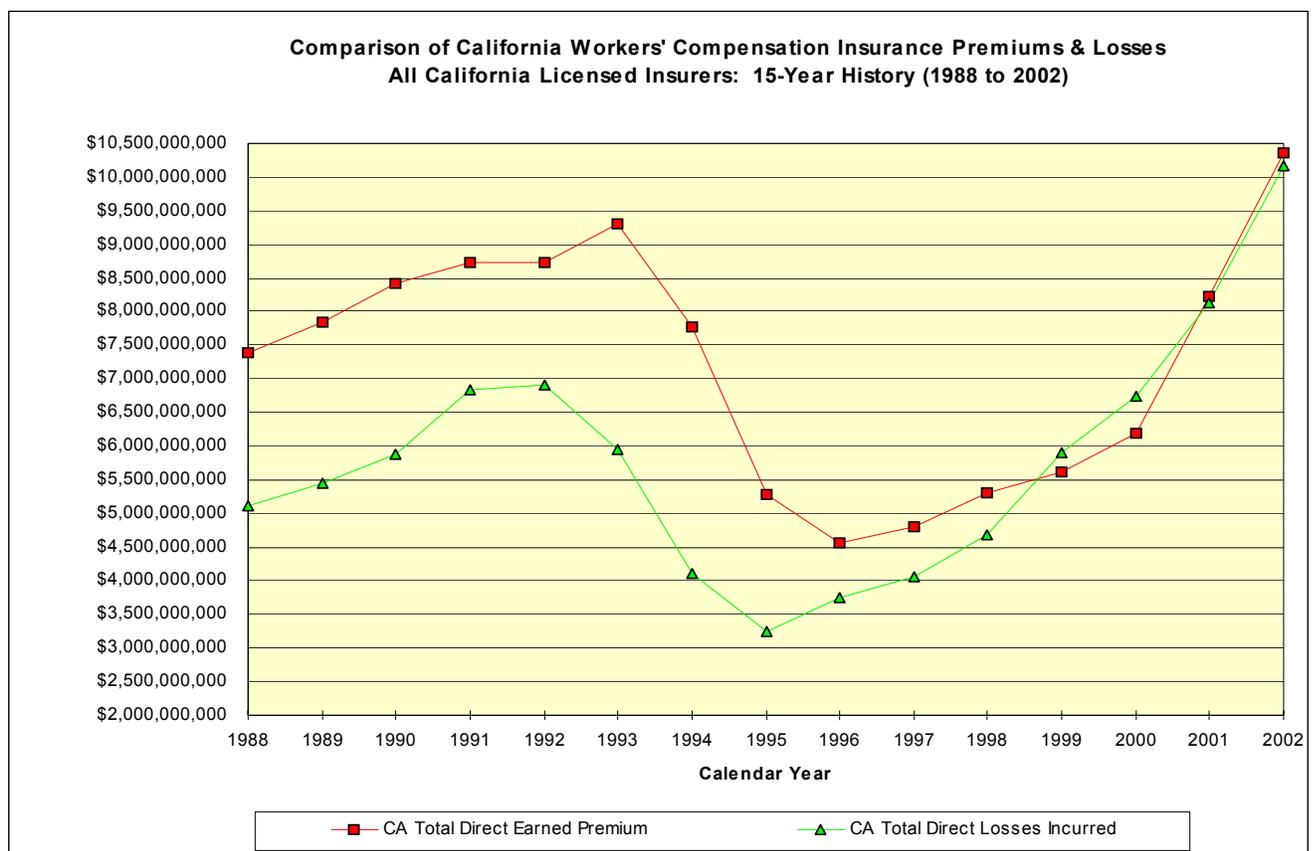
From 1989 to 1994, the rate level changes applied to the "Manual" Rates. The California Minimum Rate Law was repealed by the Legislature via SB 30, and was replaced with competitive rating (open rating) – effective January 1, 1995. Thereafter, the WCIRB's rate filings applies to advisory pure premium rates.

Workers' Compensation Insurance Experience

The following graph displays the historical premium and loss experience for the workers' compensation insurance industry in California, from 1987 to 2001. The graph shows the Total Losses Incurred and Total Earned Premium for all insurers licensed to write workers' compensation insurance in California for the past 15 years.

In the graph, "Losses Incurred" is the total amount incurred as reported in the insurers' annual statements. Incurred losses include medical costs, indemnity costs (death and disability payments), incurred but not reported losses, and adjustments for prior years' losses. It consists of actual paid losses and reserves for unpaid losses. "Losses Incurred" does not include the additional expenses incurred to investigate and settle the specific claim, or the insurer's underwriting expenses (commissions, acquisition costs, taxes, office administration overhead and fixed expenses, etc.). The graph shows that the overall incurred losses have been on an increase since 1995.

On the revenue side, "Earned Premium" is the total amount of premiums earned during the calendar year on the expired portion of the policy. Premiums had reduced substantially from 1994 to the lowest level in 1996, and gradually increased from 1996 to 2001. However, starting in 1999, high loss development had gradually and steadily caught up to the lower premiums charged.



The Department is continuously monitoring the workers' compensation insurance market and is exploring all options that would stabilize the current situation. The Department, like any consumer, is very concerned about high insurance rates, particularly if such high rates do not appear justified. However, we do expect insurance companies to set reasonable rates that are adequate to pay the

benefits that they are obligated to pay injured workers. It does not help policyholders (employers) or their workers to have low rates, if the insurers are subsequently unable to pay their claims. Given the difficult market conditions facing the workers compensation industry and the significant rate increases that have been implemented over the past 3 years, it is strongly recommended that employers comparison shop for coverage from the various licensed insurers.

If you encounter problems or have further questions, please contact the Department's Consumer Hotline at: 1-(800)-927-HELP. Outside California, please call 1-(213)-897-8921.